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Price for succes

by Anthony Pericle

The first chapter of the book "Price for Success" is titled The Cost of Doing Business. While reading the title, you might have said to yourself, "I thought this book was about price." Well, it is. But cost plays a very important role in price. You may find opportunities to increase your selling margin by better understanding and managing cost.

What is the right definition of cost? Is it acquisition cost? What about handling charges or in-bound freight? Should that be considered a part of cost? What about a supplier whose packaging leads to an abnormally high breakage rate or whose fill rates are significantly lower than the norm? Ideally, these are all costs that would be reflected in the basis of price.

Whenever you enter into an agreement to establish a selling price based on cost, allow yourself to "burden" the cost with an accurate reflection of what that cost is. (Some companies call this burdened cost commissioned cost or loaded cost.) Burdening cost will help inform your sales force that there are many costs associated with selling a product that need to be taken into consideration when setting a price for a customer. The added benefit here is that by burdening cost you will automatically increase your margin with your sales reps who take a "divide by .75" approach to pricing.

Some distributors hide cost from their field sales representatives and provide a recommended sell price with an associated floor price. There is benefit to this structure; however, making the decision to begin hiding cost from sales reps can be difficult for distributors who have been showing costs to their reps for years. Other distributors base price on the average or weighted cost of the product. This results in significant price fluctuations to the customer as the distributor's costs go up and down.

Given the popularity of using product cost as the basis for price, there is still a very low rate of adoption of activity-based costing (ABC) in setting prices. Activity-based costing is a method of applying indirect costs (freight, storage, obsolescence) to specific items, vendors or customers based on cost drivers. The risk of using product cost as a basis for pricing without ABC is that you may be erroneously assuming that similar products have similar indirect costs. Consequently, you could be missing an opportunity to create a disincentive for those suppliers with higher indirect costs.

Why it's important to understand "Cost-to-Serve"

If there's one thing that you can't overemphasize to those in charge of determining a selling margin, it is the cost of doing

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business.

Distribution is expensive. Management understands this and strives to control costs to maximize the company's overall profitability. However, sales reps and others charged with the most important profit driver — pricing — typically do not understand the full cost to serve within distribution.

When a distributor sales rep quotes a price, what do they usually say?

- A) "Your price is X, but I can probably do better."
- B) "Your price is X," then and if there is any hesitation from the customer, "but I can do better."
- C) "How does X sound?"
- D) "Your price is X."

One reason most sales reps choose A, B or C is that they do not understand the cost to serve.

When sales reps think of distribution, here is their typical understanding of the process:

- 1) I take the order from the customer.
- 2) I call the order into my warehouse.
- 3) My warehouse ships the order to the customer.
- 4) I get paid.

"I," "My." Clearly, there is something missing in the rep's understanding of the distribution process.

Here is a better overview of the cost of distribution:

- 1) Investments in warehouse, inventory, infrastructure, personnel
- 2) Vendor/product line decisions
- 3) Product ordered from vendor
- 4) Product received into warehouse
- 5) Product checked for accuracy of shipment
- 6) Product staged for shelf placement
- 7) Product put on shelf
- 8) Product stored on shelf (carry costs)
- 9) Vendor invoice received
- 10) Vendor invoice processed
- 11) Outdates, shrinkage, damaged goods
- 12) Reconciliation of errors from vendor (shipment and/or

invoice)

13) Sales rep training/investment

14) Cold calls to prospective customers

15) Relationship building with customers

16) Rep takes order from customer

17) Rep calls order to warehouse

18) Customer service enters order into system

19) System produces pick ticket

20) Order picked

21) Order checked

22) Order packed

23) Order staged for shipment

24) Order shipped

25) Invoice to customer

26) Reconciliation of errors to customer (shipment and/or invoice)

27) Invoiced payment collected

28) Sales commission paid

One concept that will definitely build pricing confidence with sales reps or those in charge of setting sell price is the understanding of cost to serve. At your next sales meeting, have your reps break up into teams of two to four and brainstorm on this topic. Pose the question, "What are the steps of fulfilling an order?" and have them write on separate pieces of paper their thoughts on this process. After 10 or 15 minutes, consolidate each team's steps and ask for help from the entire group in posting each step in sequential order. Be prepared to help fill in any gaps to demonstrate the multitude of steps in this process. This exercise to improve your reps' understanding of the cost-to-serve can make a significant impact, especially on your more junior sales reps.

A sales rep asked his manager what method to use in charging a customer. The rep was told that all products fell into one of two margin ranges (GM%):

1) 20% to 25% margin for "everyday" items

2) 25% to 30% for all other items

The rep thought he was the "king of margin" when he sold an item with a margin of 40%! But most of these items were sold "each" (12 each per box/10 boxes per case) with an "each" cost of less than \$1. A customer purchased two each of an item with a cost of 50 cents. The rep sold these items for 83 cents each (combined GM\$ of 66 cents). If he had

understood and considered the cost to service these items (breaking the case, breaking the box, repacking, potential for breakage, etc.), he would have been more confident in charging a higher margin.

The true cost to serve has a big impact on establishing proper pricing. Ignoring this cost to serve for individual products is often a big factor that contributes to lower profitability. Distributors who commit to understanding their cost to serve and educating their sales reps (and, in turn, their customers) about the costs associated with delivering their products will take an important step towards improving profitability. c

Excerpted from the book "Price for Success: A Practical Guide for Improving Margins in Wholesale Distribution" published by the National Association of Wholesaler-Distributors (NAW). To order a copy, visit www.naw.org. Tony Pericle is principal of Advanous, a division of EnterBridge Technologies Inc., which helps distributors generate higher profits through more effective margin management.

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